DEPARTMENT OF STATE REVENUE

04-20170218.LOF

Letter of Findings Number: 04-20170218
Use Tax
For Tax Years 2011-2014

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Indiana Steel Mill's rentals of scaffolding were taxable lease transactions, however, separately stated labor charges were not taxable.

ISSUE

I. Use Tax–Imposition.

Authority: IC § 6-8.1-5-1; IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-4-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-1-21; *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012); *Indiana Dep't of State Rev. v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014); *Rhoade Island v. Indiana Dep't of Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002); *USAir, Inc. v. Indiana Dep't of State Revenue*, 623 N.E.2d 466, 468-69 (Ind. Tax Ct. 1993); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97(Ind. Ct. App. 1974); *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988); *Mason Metals Company, Inc. v. Ind. Dep't of State Revenue*, 590 N.E.2d 672 (Ind. Tax 1992); *AWHR America's Water Heater Rentals, LLC v. Indiana Department of State Revenue*, 941 N.E.2d 573 (Ind. Tax Ct. 2010); 45 IAC 2.2-2-1; 45 IAC 2.2-3-4; 45 IAC 2.2-4-27; 45 IAC 2.2-5-3; 45 IAC 2.2-5-6; 45 IAC 2.2-5-8; 45 IAC 2.2-5-9; 45 IAC 2.2-5-10; Letter of Findings 05-0328 (February 28, 2007); Letter of Findings 04-20130249 (April 30, 2014); Supplemental Letter of Findings 04-20110484 (November 28, 2012); Letter of Findings 04-20120467 (March 27, 2013).

Taxpayer protests the imposition of use tax.

II. Sales Tax–Separately Stated Labor Charges.

Authority: 45 IAC 2.2-4-27.

Taxpayer alternatively protests the imposition of tax on separately stated labor charges on scaffolding rental invoices.

STATEMENT OF FACTS

Taxpayer is a steel mill located in Indiana. Taxpayer is capable of making a full range of flat products including advanced high strength steel as well as hot-rolled sheet, cold-rolled sheet, hot dip galvanized sheet and bar products. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit on Taxpayer's books and records for tax periods 2011 through 2014. The audit resulted in an overall refund of use tax to the Taxpayer. However, use tax was assessed on Taxpayer's rented scaffolding systems, which Taxpayer timely protested. An Administrative Hearing was held in which Taxpayer's representative explained the basis of the protest. This Letter of Findings results. Additional facts will be supplied as necessary.

I. Use Tax–Imposition.

DISCUSSION

The Department conducted a sales and use tax audit on Taxpayer's books and records for tax years 2011 - 2014.

As a result of that audit, use tax was assessed on Taxpayer's rental of scaffolding systems during the audit period. Taxpayer believes that these rentals should not be subject to tax.

As a threshold issue, it is a taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Thus, the taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). When an agency is charged with enforcing a statute, the jurisprudence defers to the agency's reasonable interpretation of that statute "over an equally reasonable interpretation by another party." *Indiana Dep't of State Rev. v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014).

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a); 45 IAC 2.2-2-1. A person who acquires tangible personal property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC §6-2.5-3-2(a). "Use" is defined by IC § 6-2.5-3-1(a) as "the exercise of any right or power of ownership over tangible personal property." The use tax is functionally equivalent to the sales tax. *See Rhoade Island v. Indiana Dep't of Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002). When tangible personal property is used, stored, or consumed in Indiana, use tax is due unless sales tax was paid at the time of the transaction. 45 IAC 2.2-3-4.

By complementing the sales tax, the use tax ensures that non-exempt retail transactions that escape sales tax liability are nevertheless taxed. *Rhoade*, 774 N.E.2d at 1048; *USAir, Inc. v. Indiana Dep't of State Revenue*, 623 N.E.2d 466, 468-69 (Ind. Tax Ct. 1993). To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. IC § 6-2.5-3-2(a); *USAir, Inc.*, 623 N.E.2d at 468. A taxable retail transaction occurs when (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. *See* IC § 6-2.5-1-2; IC § 6-2.5-4-1(b) and (c); IC § 6-2.5-3-2(a) and (b).

As a general rule, all purchases of tangible personal property are taxable unless specifically exempt by statutes or regulations. 45 IAC 2.2-5-3(b); 45 IAC 2.2-5-6(a); 45 IAC 2.2-5-8(a); 45 IAC 2.2-5-9(a); 45 IAC 2.2-5-10(a). An exemption from the use tax is granted for transactions where sales tax was paid at the time of purchase. There are other various tax exemptions outlined in IC § 6-2.5-5. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. *Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97(Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id*. at 101 (internal citations omitted). In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

The issue in the instant case is whether or not Taxpayer's rental/lease of scaffolding is taxable. Taxpayer rents scaffolding systems which its employees use to access certain areas of the facility for repairs and maintenance. Taxpayer generally uses the same scaffolding vendor ("Vendor") for all of its scaffolding needs. Taxpayer requires Vendor to accept and comply with its Contractor Safety, Health and Environment Handbook ("Handbook"). Per Taxpayer, it "requires strict compliance with the Handbook, and [Taxpayer] will not hire a contractor until the contractor is aware of and agrees to observe the rules and safe work practices required by the Handbook." The Handbook claims that "[b]y issuing these rules and work practices and insisting upon compliance with them, [Taxpayer] does not undertake to manage, direct, control or otherwise assume responsibility for the safety performance of Contractors . . . ." According to the Handbook, every Contractor is "required to attend [Taxpayer] site safety training sessions at least annually." Though Contractors are responsible for relaying the safety information to their own employees, a "designated [Taxpayer] representative will communicate any relevant site specific and other requirements to the Contractor, and will monitor Contractor's activities."

Generally, all contractors must "meet daily with the designated [Taxpayer] representative before beginning work

to ascertain any changed operating conditions . . . ." Further, the Handbook dictates that the designated Taxpayer representative monitors but does not direct a contractor's work. The Handbook defines "monitoring" as "inspection of the work site; review of necessary work permits and gas checks; and observing whether [Taxpayer] safe work rules and practices . . . are being followed." Taxpayer may stop or suspend a contractor's work if it does not comply with established safety regulations and can terminate a contractor for failing to comply with the Handbook.

Contractors whose work falls under "Overhead Work" such as scaffolding have their own specific rules in the Handbook. These Contractors "are to assess the work site and select and provide fall protection measures compatible with the work performed. Fall protection generally can be provided through use of guardrail systems, safety nets, and personal fall arrest systems, positioning systems, warning lines, and controlled access zones." Further, Overhead Work contractors must "designate a trained, competent person to oversee scaffold erection, dismantling and use." Any and all of a contractor's employees who are "involved in erecting, disassembling, moving, operating, repairing, maintaining, or inspecting a scaffold" must be trained to "recognize any hazards associated with the work." Each of Vendor's employees are union carpenters who, per union requirements, must "complete a minimum of forty (40) hours of scaffolding training and testing and hold specialized cards to show proof of training." The bar code on the back of this card allows access to the carpenter's training history. Finally, the Handbook dictates that the Overhead Work contactors *[sic]* "must inspect scaffolding each work shift and after any event that could affect the structural integrity of the scaffold."

Taxpayer explains that when a scaffolding "project need arises, [Taxpayer's] Operations and Engineering Management . . . describes the project to [Vendor], whose representative will design the scaffolding and develop a cost estimate based on that design." Vendor erects the scaffolding and "operate[s] the scaffolding through its union trained carpenters, who assembled, constructed, erected, anchored, modified, and moved the scaffolding and its component parts." Taxpayer requires a Vendor carpenter to "inspect scaffolding each work shift and after any event that could affect the structural integrity of the scaffold." Taxpayer explains that upon inspection, Vendor carpenters assign one of two tags to scaffolding. The yellow tags note the time of inspection, identify specific hazards, are signed by the foreman or carpenter in charge and contain the following warning: "Do Not Alter Scaffolding. Doing so can cause injury or death." Taxpayer employees cannot access scaffolding until it has a yellow tag. If a Vendor carpenter affixes a red tag to the scaffolding, it cannot be accessed. During the hearing Taxpayer provided pictures of these tags and reiterated that Vendor, not Taxpayer, "controls whether the scaffolding may be accessed on shift."

According to Taxpayer, it "does not supervise, inspect, or control the work of [Vendor's] union carpenters. If scaffolding changes or modifications are needed, they are completed by a [Vendor] representative. [Vendor] union carpenters are virtually always on site at [Taxpayer's] plants . . . [and] are frequently kept on site in case changes or modifications to the scaffolding are necessary." If Vendor carpenters aren't on site, they are at least on call to provide scaffolding services. Once a project has concluded, Vendor employees "[disassemble] the component parts and remove them from the job site." Upon conclusion, Vendor issues Taxpayer an invoice. The invoices separate out labor costs, equipment costs, material costs, scaffolding rental and other costs.

In the audit report, the Department noted that the scaffolding rentals "did not include sales tax and use tax was not self assessed." Therefore, the audit assessed use tax "on all items included in the rental invoice which includes labor charges to erect the scaffolding." The audit report cited 45 IAC 2.2-4-27(d) as the authority for the assessment. 45 IAC 2.2-4-27(d) states: "The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable."

Taxpayer argues that "[b]oth the Indiana Code and the Department's regulation limit the taxation of tangible personal property that is provided with an operator." Taxpayer cites to IC § 6-2.5-1-21(a)(3) noting that this code section "excludes from the definition of a taxable lease those transactions where tangible personal property is provided with an operator for a fixed or indeterminate period . . . ." This exclusion applies only if "the operator is necessary for the equipment to perform as designed; and the operator does more than maintain, inspect, or set up the tangible personal property." IC § 6-2.5-1-21(a)(3).

The taxability of rentals or leases of tangible personal property with an operator is further explored under 45 IAC 2.2-4-27(d)(3). The regulation states, in pertinent part:

> (A) The renting or leasing of tangible personal property, together with the services of an operator shall be subject to the tax when control of the property is exercised by the lessee. Control is exercised when the lessee has exclusive use of the property, and the lessee has the right to direct the manner of the use of the property. If these conditions are present, control is deemed to be exercised even though it is not actually exercised.

> (B) The rental of tangible personal property together with an operator as part of a contract to perform a specific job in a manner to be determined by the owner of the property or the operator shall be considered the performance of a service rather than a rental or lease provided the lessee cannot exercise control over such property and operator.
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> (C) When tangible personal property is rented or leased together with the service of an operator, the gross retail tax or use tax is imposed on the property rentals. The tax is not imposed upon the charges for the operator's services, provided such charges are separately stated on the invoice rendered by the lessor to the lessee.

Taxpayer interprets this regulation to mean that control is the critical factor in "determining whether a transaction is a non-taxable service." According to Taxpayer:

> To be a taxable lease, the Department's regulation requires the purported lessee to exercise control of the subject tangible personal property. The purported lessee exercises control when it has (i) "exclusive use of the property" and (ii) "the right to demand the manner of the use of the property." If both conditions are present, the rule explains "control is deemed to be exercised even though it is not actually exercised." According to the Department's rule, when personal property is rented with an operator to perform a specific job, the transaction is a non-taxable service if the purported lessee "cannot exercise control over such property and operator."
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> (Internal citations omitted).

The Indiana Tax Court has also interpreted 45 IAC 2.2-4-27(d)(3). In *Mason Metals Company, Inc. v. Indiana Dep't of State Rev.*, 590 N.E.2d 672 (Ind. Tax Ct. 1992), it was the lessee's lack of control over rented equipment which was crucial to the Tax Court's decision that the lease in question was not subject to sales and use tax. In that case, Mason Metals, a recycling company, sought the refund of sales taxes paid on tractors it leased from a third party ("American"). According to the terms of the lease, the tractors were "under exclusive and complete possession, use and control of [Mason Metals]." *Mason Metals Co.*, 590 N.E.2d at 673. Based on the terms of the lease, the Department denied Mason Metals' claims for refund.

The Tax Court took a different view. The Court noted that though Mason Metals leased the tractors, American owned the tractors. American provided the tractors and a driver to Mason Metals and paid sales tax on the purchase of the tractors. The drivers were American employees and their actions were directed by American. American performed repairs and maintenance on the tractors, purchased fuel for the tractors and stored them when not in use. Mason Metals paid for insurance on the tractors, but was reimbursed by American.

The Court acknowledged that under 45 IAC 2.2-4-27(d)(3) "lease transactions are not subject to sales and use tax unless the lessee has control over the leased property . . . ." *Mason Metals Co.*, 590 N.E.2d at 675. In the case of Mason Metals, though the lease agreement appeared to give Mason Metals such control, the evidence showed that in practice, Mason Metals "did not have the possession and control of the tractor . . . necessary to characterize its transactions as a leasing of property subject to sales and use tax." *Mason Metals Co.*, 590 N.E.2d at 676.

In another Indiana Tax Court case, it was the lessee's control of the leased property which made the lease transaction subject to Indiana sales tax. In *AWHR America's Water Heater Rentals, LLC v. Indiana Department of State Revenue*, 941 N.E.2d 573 (Ind. Tax Ct. 2010), a water heater rental company argued that "because it never transferred possession and control of the water heaters to its customers, it did not 'lease' them" and were therefore not subject to tax. *Id.* at 575. In that case, AWHR installed water heaters in their customer's home or business, made repairs to the water heaters as necessary and removed the water heaters at the end of the lease term. The rental company maintained ownership of the water heaters and customers "agreed 'not to remove, transfer, tamper with, adjust or repair [the water heater] or remove the tag attached to [it] evidencing [AWHR's] ownership[.]'" *Id*. at 574. Customers also agreed to give AWHR "access to the [water heater] at all reasonable times for the purpose of examining [ ] and repairing [it]." *Id*.

In an audit the Department determined that AWHR should have collected sales tax on the leased water heaters. AWHR believed that "because it was obligated to provide repair service during the term of the agreements, it could not, and did not, relinquish its possession and control over the water heaters to its customers." *Id*. at 575. AWHR argued that "because it never transferred possession and control of the water heaters to its customers, it did not 'lease' them." *Id*. In its analysis, the Tax Court emphasized that the water heaters were installed in

customer homes and businesses, customers controlled access to the water heaters, customers determine when to use the water heaters and how much to use them and customers provided the water and electricity needed to power the water heaters. Therefore, the Tax Court determined that, given the facts, "AWHR's customers had the requisite possession of, and control over, AWHR's water heaters to characterize the transactions as lease transactions." *Id*. at 576.

Taxpayer cites to several of the Department's Letters of Finding to support its claim that transactions in which personal property is rented with an operator are non-taxable services if the purported lessee exercises no control over the property and the operator. In Letter of Findings 05-0328 (February 28, 2007), 20070228 Ind. Reg. 045070105NRA, Manufacturer protested sales tax which was assessed on crane rentals. The cranes in question were used to lift and place Manufacturer's products in specific locations. Manufacturer did not own the cranes or employ the crane operators. The Department determined that because the crane operator, not Manufacturer, maintained control of the crane, the rentals were not taxable. Conversely, in Letter of Findings 04-20130249 (April 30, 2014), 20140430 Ind. Reg. 045140122NRA, protesting Company rented equipment to its customers and provided operators for that equipment. The Department determined that Company was able to show that while the Company provided operators with the equipment it rented to its customers, the customers themselves had sole control over the equipment and the operators' actions. Because customers had control over the equipment, the rentals were taxable.

In Supplemental Letter of Findings 04-20110484 (November 28, 2012), 20121128 Ind. Reg. 045120600NRA, a medical practice argued that where an operator is "necessary for the equipment to perform as designed" and that operator does "more than maintain, inspect, or set up the tangible personal property," the transaction in question is not a taxable lease under IC § 6-2.5-1-21. In this case, a medical practice contracted with a third party to provide imaging equipment and operators for that equipment. The medical practice claimed that its employees were not qualified to operate the equipment and therefore the third party's employees were necessary for the equipment to function properly. The Department agreed that under the circumstances, "the contract in question [was] not a 'lease' as defined under IC § 6-2.5-1-21," and medical practice was sustained. *Id*.

Finally, Taxpayer points to Letter of Findings 04-20120467 (March 27, 2013), 20130327 Ind. Reg. 045130107NRA, in which a coal processor rented semi-trucks or "low boys" from a third party. The third party did not charge sales tax for these rentals. The coal processor provided copies of "slip tickets" which it claimed to use with the equipment operator "to sign off and approve the description of equipment used, the time for which it was used, and the applicable rate." *Id*. The coal processor believed that these slip tickets proved that "the vendor's operator maintains control and possession of the vehicles, that the operator is 'necessary' for the operation of the vehicle, and that [coal processor] 'never operates any gear lever, wheel, or other control on the equipment.'" *Id*. The coal processor also provided an affidavit from the vendor's vice-president which indicated that the "equipment supplied by vendor 'required special licenses and training to operate,' that vendor 'always provided an operator with the equipment,' and that the vendor's employees 'were the only individuals to operate the equipment.'" *Id*. The Department agreed that the coal processor provided "sufficient documentation to establish that the transactions at issue involved the rental of equipment along with an associated operator and that the transactions [fell] within the exemption set out at IC § 6-2.5-1-21(a)(3)." *Id*.

The Department finds that the instant case has similarities to both *AWHR* and *Mason Metals*. As in both cases, the scaffolding is owned by vendor at all times, though, as in *AWHR,* it is located within the Taxpayer's facility. Like the lessor in *AWHR*, Vendor has specially trained employees who install the scaffolding and who maintain and repair the scaffolding when necessary. These employees remove the scaffolding at the end of the project. Before each shift, Vendor employees are informed by Taxpayer of any changes or situations which may have affected the safety of the scaffolding. Vendor employees then inspect the scaffolding and make any necessary repairs.

Like the customers in *AWHR*, Taxpayer employees agree not to access or tamper with the scaffolding unless Vendor has given permission. Vendor employees are either on site or on call at all times to address any scaffolding issues that may arise. Like the customers in *AWHR*, Taxpayer controls Vendor's access to the scaffolding as a whole, however, Vendor controls Taxpayer's employee's access to the scaffolding. Like the drivers in *Mason Metals*, the carpenters who install, repair and dissemble the scaffolding are not Taxpayer employees. However, unlike the drivers in *Mason Metals*, their actions are at least in part directed by Taxpayer. Taxpayer mandates that Vendor employees have a certain level of training and comply with Taxpayer's safety handbook. Taxpayer further informs or directs Vendor employees as to which scaffolding may be in need of repair and can call a Vendor employee to come on site if an issue arises.

Though Vendor's employees were necessary for the scaffolding to perform as designed, it appears that they did

little more than maintain, inspect and set up the scaffolding. Taxpayer directed how Vendor employees would monitor use of the scaffolding via the rules set out in the Handbook. So while only Vendor employees could repair scaffolding and Vendor employees dictated when Taxpayer employees were permitted to access scaffolding; that was all by design of the Handbook. Taxpayer has essentially controlled the use of the equipment on the front-end of the project and allows Vendor to work within that control. Taxpayer has not provided sufficient evidence to show that it, as lessee, it did not have **exclusive** use of the property and could not direct the manner of use of the property, as provided under IC § 6-2.5-1-21(a)(3). As such, Taxpayer's protest is denied.

FINDING

Taxpayer's protest is denied.

II. Sales Tax–Separately Stated Labor Charges.

DISCUSSION

Taxpayer argues that "[i]f the Department concludes [Taxpayer] is leasing the scaffolding components, [Vendor's] separately stated labor charges by rule are not taxable. Taxpayer cites to 45 IAC 2.2-4-27(d)(3)(C) in support which states:

> When tangible personal property is rented or leased together with the service of an operator, the gross retail tax or use tax is imposed on the property rentals. The tax is not imposed upon the charges for the operator's services, provided such charges are separately stated on the invoice rendered by the lessor to the lessee.

Taxpayer provides samples of scaffolding invoices which clearly separate out labor costs from equipment, material, and other costs. The labor costs are even supported with a breakdown of which Vendor employee worked on a particular day and how much was charged for that employee. The Department agrees that Taxpayer should not be subject to tax on the labor charges and a supplemental audit will be conducted to adjust the assessment accordingly.

FINDING

Taxpayer's protest is sustained.

SUMMARY

Taxpayer's rental of scaffolding equipment was a taxable lease transaction, however, separately stated labor charges are not subject to tax.

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An html version of this document.